UNITED STATES DEPARTMENT OF AGRICULTURE

BEFORE THE SECRETARY OF AGRICULTURE

In re:	)	
	)	P & S Docket No. D-95-49
IBP, inc.,	)	
	)	
Respondent.	)	
	)	**Decision and Order**

Preliminary Statement

This is a disciplinary proceeding under the Packers and Stockyards Act, 1921, as amended and supplemented (hereinafter Packers and Stockyards Act, the Act, or PSA) (7 U.S.C. § 181 *et seq.*). The proceeding was instituted on August 3, 1995, by a Complaint filed by the Deputy Administrator of the Packers and Stockyards Programs, Grain Inspection, Packers and Stockyards Administration, United States Department of Agriculture. The Complaint alleges that Respondent IBP, inc., beginning in 1994 and continuing through the present, purchased cattle under an exclusive marketing agreement in violation of the Packers and Stockyards Act. Specifically, the Complaint stated that Respondent was giving an undue or unreasonable preference to a select group of feedyards known as the Beef Marketing Group, by using the Kansas practical top price, adjusted for quality, to calculate bids; and engaged in discriminatory practices by not offering the same pricing method to other feedyards.

On August 28, 1995, Respondent filed an Answer in which it admitted to purchasing cattle from the Beef Marketing Group under terms which it did not offer to other feedyards, but denied that the agreement violated the Packers and Stockyards Act.

An oral hearing was held in Kansas City, Missouri, from January 29, 1997 through February 7, 1997; in Washington, D.C., from February 12, 1997 through February 21, 1997; in Sioux City, Iowa, from March 10, 1997 through March 12, 1997; and in Washington, D.C., from

April 14, 1997 through April 15, 1997. Complainant was represented by JoAnn Waterfield and Timothy Morris. Respondent was represented by Charles W. Douglas and William H. Baumgartner, Jr., Chicago, Illinois, and Lonnie O. Grigsby and Nathan A. Hodne, Dakota City, Nebraska.

The parties filed proposed findings, conclusions and orders on June 17, 1997, and filed reply briefs on July 22, 1997. On August 6, 1997, Respondent filed a motion to strike portions of Complainant's Reply Brief on the grounds that it made new arguments and referred to unadmitted evidence. On August 25, 1997, Complainant filed a Memorandum in Opposition to IBP's Motion to Strike Portions of the Reply Brief. Respondent's motion to strike is granted with respect to the unadmitted evidence, and denied with respect to the new arguments.

Complainant cited a number of economic journals and treatises in an attempt to refute the testimony of Respondent's expert witness. (Reply Brief at 18 n. 2, 74-75). None of these publications were admitted, or even presented for consideration at the hearing. Although the materials may have been properly admitted during the hearing if they had been established as authoritative,[1] it is not proper for them to be made part of the record via a post-hearing submission. *See Tagats v. Marquette University*, 681 F. Supp. 1344, 1351 (E.D. Wis.), *aff'd*, 861 F.2d 1040 (7th Cir. 1988).

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[1]Learned treatises are traditionally subject to very limited admissibility. The Federal Rules of Evidence allow for their admission as an exception to the prohibition on hearsay as follows:

> **Learned treatises**. To the extent called to the attention of an expert witness upon cross-examination or relied upon by the expert witness in direct examination, statements contained in published treatises, periodicals, or pamphlets on a subject of history, medicine, or other science or art, established as a reliable authority by the testimony or admission of the witness or by other expert testimony or by judicial notice. If admitted, the statements may be read into evidence but may not be received as exhibits.

F.R.E. 803(18).

Learned treatises must be offered into evidence with the same formalities as any other type of evidence, because "it is only through the requirement of a minimal yet distinct, specific offer of articulated and identifiable evidence that the Court can examine the relevance or the completeness of evidence, as well as all other elements bearing on the admissibility of the offer. . . . In addition, . . . minimal trial practice requirements must be expected to accompany offers of evidence of this nature if opposing counsel is to fulfill his or her obligations." *Maggipinto v. Reichman*, 481 F. Supp. 547, 551 (E.D. Pa. 1979). By failing to follow basic procedural requirements necessary for the presentation of evidence, Complainant both denied Respondent the opportunity for cross-examination, and failed to establish the admissibility of the publications.

Complainant failed to establish that the publications at issue were authoritative, either through one of its own expert witnesses, or through Respondent's. Such qualification is required before a treatise can be relied on. "[A]n article does not reach the dignity of a "reliable authority" merely because some editor, even a most reputable one, sees fit to circulate it." *Meschino v. North American Drager, Inc.*, 841 F.2d 429, 434 (1st Cir. 1988). Furthermore, the authority of the publications cannot be established through official notice since the materials are not matters of common knowledge. *See Generella v. Weinberger*, 388 F. Supp 1086, 1090 (E.D. Pa. 1974) (citing *Cook v. Celebrezze*, 217 F. Supp. 366, 368-69 (W.D. Mo. 1963). Accordingly, all references to the cited publications are stricken and have not been considered.

In addition, Complainant's Reply Brief contained some new arguments made in response to economic theories found in Respondent's Brief. (Complainant's Reply Brief at 38-40, 74-75). The arguments do not present new claims or issues, rather they respond to arguments previously made. It is not inappropriate for Complainant to present arguments in response to any of Respondent's arguments, so long as they are consistent with the Complaint's allegations and the issues presented at the hearing.

Accordingly, all arguments have been considered to the extent that they are supported by evidence in the record. All proposed findings and conclusions have also been considered. To the extent indicated they have been adopted, otherwise they have been rejected as irrelevant or not supported by the evidence. Complainant's exhibits are referred to as "CX." Respondent's exhibits are referred to as "RX." The transcript of the hearing is referred to as "Tr."

Upon consideration of the record evidence, the arguments of the parties, and for the reasons hereinafter stated, an Order is being entered dismissing the Complaint.

Findings of Fact

1. Respondent, IBP, inc., is a Delaware corporation with its headquarters located in Dakota City, Nebraska. IBP is and at all times material herein was a packer within the meaning of the Packers and Stockyards Act. (Answer).

2. Respondent began operations in 1961 with one plant in Denison, Iowa. Subsequently, IBP added ten fed cattle packing plants across the United States and entered the pork and non-fed cattle businesses as well. (Tr. 3352-53, 3355).

3. In 1996, Respondent had total sales of approximately $13 billion. Sales of products derived from fed cattle account for approximately eighty percent of Respondent's sales. (Tr. 3357).

4. Respondent's primary competitors in the current market are Monfort, Inc. (a subsidiary of Conagra, Inc.), Excel Corporation (a subsidiary of Cargill, Inc.), and National Beef Packing Company (a subsidiary of Farmland Industries). Together with IBP, these packers collectively account for between seventy and eighty percent of the fed cattle slaughter in the United States. (Tr. 3364).

5. Respondent purchased its Emporia plant in eastern Kansas in 1968 and began operations there in 1969. Since then the plant's capacity has increased from 2,800 head per day to 4,000 head per day. (Tr. 2890, 3499-3500). The plant generally operates eleven shifts--two each day during the week and one on Saturday. To operate a packing plant at a profit, a packer must generally run at near capacity. (Tr. 3368-69). The Emporia plant employs between 2,500 and 2,600 workers. Each shift is guaranteed forty hours of work per week, even if Respondent is unable to acquire enough cattle to run complete shifts. (Tr. 3501-03).

6. Before cattle are sold to packers in Kansas, they are typically sent to feedyards, where high energy rations are fed to them in order to add flecks of fat to the animals' muscle--known as marbling--thereby improving the taste and tenderness of the beef. While in the feedyard, cattle typically gain about three pounds per day. One pound of gain requires approximately seven pounds of feed. Cattle generally remain at the feedyard for between 120 and 150 days, until reaching a weight of approximately 1200 pounds. At that point they are sold to a packer. (Tr. 3339-44).

7. The standard practice in Kansas is for cattle to be delivered within 7 days of the sale. (Tr. 134). Cattle are typically slaughtered on the same day they arrive at the plant. (Tr. 3473).

8. Packers in Kansas generally purchase fed cattle using one of the following four methods: 1) live, 2) flat, in the beef, 3) grade and yield sales, or 4) forward contracts. (Tr. 3458-60).

9. In live cattle sales, packers pay for cattle based on their weight while they are alive. Cattle are usually weighed at the feedyard on the day the cattle are picked up. Bids are expressed in dollars per hundredweight. (Tr. 3458).

10. In the traditional method of selling cattle on a live basis, packer buyers visit the feedyards, where they are presented with a show list identifying the pens of cattle that are for sale that week. The buyers evaluate the cattle and bid on the pens of interest. The feedyard often must

call the cattle owner to determine whether the cattle will be sold at that price. (Tr. 132). A series of phone calls with counterproposals between the packer buyer, the feedyard, and the owner may ensue. (Tr. 3746).

11. Feedyards usually allow the first buyer who arrives at the feedyard to place the first bid. Also, a feedyard will usually sell the cattle to the first buyer to bid the price at which the cattle owner is ultimately willing to sell. For example, if every buyer bids $70 on a pen of cattle, the feedyard will sell the pen to the first buyer who bid. It is, therefore, important for the packer buyer to be the first bidder at the feedyard, and it is not uncommon for a buyer to arrive at the feedyard as early as the night before. (Tr. 466-68, 3530, 3690-91).

12. With flat, in the beef sales, packers pay the cattle owners based on the actual carcass weight of the animals at the packing plant after slaughter, rather than the total live weight of the animal at the feedyard. (Tr. 3458). In grade and yield sales, packers pay cattle owners based on a formula that takes into account both the actual carcass weight of the animals and the grade assigned to the carcass by the USDA grader. (Tr. 3459). A forward contract fixes the price to be paid for cattle several weeks or months in advance of the delivery date. (Tr. 3459).

13. Respondent purchases cattle using all of the above methods. (Tr. 3458-60).

14. The Beef Marketing Group (BMG) is made up of nine feedyards in central Kansas that joined together in 1988 to share information and develop more effective marketing methods for their cattle. (Tr. 3713-14). The original BMG members are Barton County Feeders, Dudrey Cattle Company, Golden Belt Feeders, Great Bend Feeding, Knight Feedlot, Mull Farms, Pawnee Valley Feeders, Pratt Feeders, and Ward Feed Yard. Additional feedlots have been included based on an ownership interest of the original members. (Tr. 454).

15. In 1990, BMG entered into a marketing arrangement with Excel under which BMG members were entitled to sell cattle to Excel on a forward contract basis, which guaranteed BMG members the highest basis that Excel paid any producer for fed cattle delivered under forward contracts for the period in question. In return, BMG yards agreed to supply Excel with a specified minimum number of cattle. (Tr. 3727). Most of the cattle subject to the agreement were Holstein cattle. (Tr. 3720-21, CX 2 at 22).

16. The arrangement between BMG and Excel resulted in Excel buying a substantial portion of the cattle sold by BMG yards, and BMG yards began feeding substantially more Holsteins. (Tr. 3731). Holsteins are primarily used as dairy cattle and provide lesser quality cuts of beef. IBP has little interest in purchasing Holsteins. (Tr. 3721, 3731).

17. In September 1993, the agreement between BMG and Excel was effectively terminated. (Tr. 3729-30). In January 1994, BMG representative, Lee Borck approached IBP's head buyer, Bruce Bass, with a proposal for a marketing agreement. (Tr. 3732). Competitors of IBP had already expressed an interest in participating in a marketing agreement with the BMG yards. (Tr. 582, 618, 624, 3737). In February 1994, IBP and BMG entered into the marketing agreement under terms essentially proposed by BMG. (Tr. 3733).

18. The agreement provided terms for live cattle sales which differed somewhat from traditional methods for purchasing cattle in Kansas. Instead of bidding in dollars per hundredweight, bids were made using a basis that was adjusted for quality. The basis used was the highest price paid in Kansas for at least 500 head of cattle in a given week, as reported by USDA (the Kansas practical top). Cattle which were top quality received bids of "par" or "even;" and Respondent would pay the Kansas practical top price for that pen. Cattle of lesser quality received discounted bids, for example, "minus fifty;" and Respondent would pay $0.50 per cwt. less than the Kansas top price.

Superior cattle could receive bids over the basis, for example, "plus fifty," although this rarely occurred. (Tr. 3511, 3743-44).

19. Bids were made on Monday, and had to be accepted or rejected by Wednesday. (Tr. 3513). In deciding whether to accept or reject bids, producers did not have to consider any potential changes in the market during that week. Since the bids were keyed to the Kansas practical top price for the week, producers would receive the benefit of any increase in the market value during the week, but would not be affected by any decline in value. A producer, however, would still have to consider the potential for market changes from week to week. For example, a producer might opt to sell a pen of cattle either before or after the animals reach their ideal weight, if there is some indication the price will be high enough in a given week to make up for a discount on light cattle, or for the cost of feeding the cattle for an extra week.

20. The agreement also included several non-price terms. Respondent committed to bid on every pen of cattle and was entitled to offer a separate price for each pen. (Tr. 3513, 3742, 3747-48). Respondent had until Saturday of the following week to pick up the cattle, giving it three days more than the customary period. (Tr. 3513). Respondent had a right of first refusal for all cattle on which it bid even or better. (Tr. 462, 830, 1595, 3231-32, 3511-14, 3734). Respondent agreed to share slaughter information with the feedyards. (Tr. 3514).

21. In August 1994, the basis for bidding was changed to the reported Kansas top price for 2,500 head or more. The time to accept or reject bids was moved back from Wednesday to Tuesday, and the pick up date was moved back from Saturday to Friday. In addition, the day for buyers to look at cattle was moved back from Monday to Thursday of the prior week. (Tr. 3515-16).

22. Further changes were initiated in November 1995. A new grade and yield option was added. Also for cattle sold on a live weight basis, penalties and premiums were added for cattle

yielding under or over specified amounts. The right of first refusal was expanded to include pens on which IBP bid at least the Kansas top price minus fifty cents. The basis for bidding was changed to a negotiated middle point between the Kansas top price for 2,500 head or more and the Kansas top price paid during the week by IBP (in weeks when the two prices were different). (Tr. 3515-16, 3656).

23. Two BMG members stopped selling IBP cattle under the terms of the agreement, although they have remained members of the BMG. (Tr. 537, 3766). Pratt Feeders stopped selling in February 1995. (Tr. 537). Pawnee Valley Feeders stopped selling in August or September 1996. (Tr. 3767).

24. Respondent has continued to purchase cattle from the other Kansas yards under traditional methods of purchase. Other packers have continued to purchase cattle from the non-BMG yards. Non-BMG yards have continued to receive competitive prices for their cattle after the agreement. (Tr. 3168, 3185-86, 3195-96).

25. Testimony received from owners and operators of non-BMG feedyards failed to show that they were harmed by the agreement, and, in fact, showed the opposite. Central Feeders, Inc. expanded in 1994 and 1996. (Tr. 960-61). Ottawa County Cattle Association grew from April 1994 through October 1994. (Tr. 1171). Mann's ATP, purchased a neighboring feedyard expanding capacity by 6,000 head, and has not had any difficulty filling pens. The number of its customers has doubled since 1994. (Tr. 1228-30). Mid-America feedyards has grown in capacity and occupancy over the last three years. (Tr. 1728-32).

26. The types of marketing options available at a given feedyard is a factor cattle owners consider in determining where to place cattle; however, it is not as important as other factors such

as a feedyard's reputation, cost of gain, or pen availability. (Tr. 3708-11, 3932-33, 1778, 1807, 1925).

27. There is no evidence of any injury to any competing packer resulting from the agreement.

28. There is no evidence of any injury to any owner whose cattle were fed at the non-BMG feedyards resulting from the agreement.

29. There is no evidence of any injury to any of the feedyards competing with BMG yards resulting from the agreement.

30 There is no evidence of any injury to competition in the fed cattle industry in Kansas resulting from the agreement.

Conclusions of Law

1. Respondents did not engage in or use any unfair, unjustly discriminatory, or deceptive practice or device in violation of section 202(a) of the Packers and Stockyards Act.

2. Respondents did not make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever, in violation of section 202(b) of the Packers and Stockyards Act.

Discussion

A. Applicable Law

The Complaint alleges that Respondent has violated sections 202(a) and (b) of the Packers and Stockyards Act which provides that:

> It shall be unlawful with respect to livestock, meats, meat food products in unmanufactured form, poultry, or poultry products for any packer or any live poultry dealer or handler to:

> (a) Engage in or use any unfair, unjustly discriminatory, or deceptive practice or device; or
>
> (b) Make or give any undue or unreasonable preference or advantage to any particular person or locality in any respect whatsoever, or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever; . . . .

7 U.S.C. § 192(a) and (b).

Complainant maintains that Respondent gave BMG members an undue or unreasonable preference, in violation of section 202(b), by purchasing cattle using the Kansas weekly top price as a basis for bidding. It further alleges that Respondent's failure to purchase cattle from other Kansas feedyards using the same method constitutes an unfair or unjustly discriminatory practice, violative of section 202(a).

The legislative history of section 202 indicates that Congress intended the legislation to have a more far reaching effect than existing antitrust statutes, such as the Sherman and Clayton Acts. *See Swift & Co. v. United States*, 308 F.2d 849, 853 (7th Cir. 1962). Nevertheless, courts have placed limits on the Secretary's powers to regulate practices under section 202. The Seventh Circuit first recognized these limits in *Swift & Co. v. Wallace*, stating that:

> [Section 202] does not purport to confer upon the Secretary of Agriculture any authority directly to regulate prices, or discounts, or sales methods; and clearly does not contemplate the exercise of any authority to establish uniformity of practice in respect thereto.

105 F.2d 848, 853 (7th Cir. 1939).

The Seventh Circuit reaffirmed this interpretation in *Armour and Company v. United States*, holding that:

> Section 202(a) should be read liberally enough to take care of the types of anti-competitive practices properly deemed "unfair" by the Federal Trade Commission (15 U.S.C. § 45) and also to reach any of the special mischiefs and injuries inherent in livestock and poultry traffic. However, in Section 202(a) Congress gave the Secretary no mandate to ignore the

> general outline of long-time antitrust policy by condemning practices which are neither deceptive nor injurious to competition nor intended to be so by the party charged.

402 F.2d 712, 722 (7th Cir. 1968).

The Eighth Circuit has similarly held that despite its broadness, the PSA follows the general blue print of established antitrust regulation. *See Farrow v. USDA*, 760 F.2d 211, 214 (8th Cir. 1985); *DeJong Packing Co. v. USDA,* 618 F.2d 1329, 1335 n. 7 (8th Cir.), *cert. denied* 449 U.S. 1061 (1980); *see also Jackson v. Swift Eckrich, Inc.*, 53 F.3d 1452 (8th Cir. 1995).[2]

Consequently, the agency's powers are not so broad as to overcome traditional antitrust regulations which "express a basic public policy distinguishing between fair and vigorous competition on the one hand and predatory or controlled competition on the other." *Armour & Co.*, 402 F.2d at 717.

B. Complainant failed to prove the existence of $0.43 per cwt. price difference.

The Complaint alleges that: "Respondent gives an undue or unreasonable preference to the Beef Marketing Group by guaranteeing a high price for livestock purchased from the Beef Marketing Group while refusing to make the same terms of purchase available to similarly situated sellers of comparable livestock." (Complaint at para. II(c)).[3] Specifically, Complainant contends that

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[2]The Supreme Court has not as yet interpreted these provisions of the Act, and the most recent Circuit Court decision on it is *Jackson*, decided by the Eight Circuit which is the venue where an appeal from this case shall eventually lie. *Jackson* is, therefore, controlling and has been closely followed.

[3]Complainant alleges three additional preferences for the first time in post-hearing submissions. Specifically, Complainant asserts that Respondent violated § 202(b) by giving BMG a "powerful marketing technique" not available to other yards; gave BMG yards more time within which to accept or reject bids; and gave BMG yards carcass performance information not available to other yards as a matter of right. Since these allegations were not included in the Complaint, they are beyond the scope of these proceedings and may not properly be considered. Even if they had been properly alleged, they would not constitute undue or unreasonable preferences in violation the Act. *See infra* discussion at p. 25-26, 28-31.

Respondent provided Beef Marketing Group feedyards with a price preference of $0.43 per hundredweight.[4] Complainant failed to satisfactorily prove that $0.43 per cwt. accurately represents the price difference that may have resulted from the agreement.

The alleged $0.43 per cwt. preference was derived from an analysis by the Industry Analysis Staff (IAS) of the Packers and Stockyards Programs, which examined IBP's transactions for a 20 week period in late 1993 and early 1994 that encompassed the ten weeks before and the ten weeks after the agreement went into effect.

IAS began with an examination of simple statistics surrounding the transactions. Statistics, however, only examine factors in isolation, and are, therefore, not able to show whether any price change was actually caused by the agreement or by some other factor. Recognizing the limited value of a purely statistical analysis, IAS developed a multiple regression model. Multiple regression is a statistical technique which can be used to examine the simultaneous effects of several factors on a single variable, if the model complies with various assumptions. Using the regression model, the IAS economists concluded that the price difference attributable to the agreement was $0.43 per cwt. The IAS model, however, suffers from a number of defects which render this conclusion unreliable.

Due to the complicated nature of the econometric study, both parties presented expert testimony to explain and analyze the study and its results. Dr. Gerald Grinnell and Dr. Warren Preston, two of the economists involved in the study testified on behalf of the government. Dr. Grinnell and Dr. Preston are both agricultural economists employed by USDA. Although both

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[4]Complainant also presented testimony from non-BMG feedyard operators who estimated that the value of the agreement ranged from $1.00 to $3.00 per cwt. (Tr. 772, 931, 987). These estimates were purely speculative, with no factual support whatsoever, and were made by individuals who were not aware of all the terms of the agreement. This testimony, therefore, is of scant probative value, and merits no further discussion.

have considerable expertise in the field of agricultural economics, neither has any specialized training or expertise in the field of econometrics.

Professor Jerry Hausman testified on behalf of Respondent. Professor Hausman is a recognized expert in the field of econometrics. He is a professor at MIT where he teaches econometrics. He is a former editor of the journal Econometrica; and he is the author of numerous publications on the subject. He developed a method of testing models for bias commonly known among econometricians as the "Hausman Specification Test."

According to Professor Hausman, the IAS model is biased and unreliable. With non-randomized experiments, such as the one conducted by the government, there is a critical assumption that the variable being tested is not correlated with all factors not accounted for by the developed model. The government failed to test this assumption and when Professor Hausman tested it, the model failed.

Professor Hausman explained that BMGAFTER (the variable of interest in the study) is a "catch-all" variable, which would capture any factors not accounted for in the study (for example, the identity of the cattle buyer). The government assumes that these unaccounted for factors are not correlated with the characteristics of the transactions that are included in the model; and also that those factors had the same effect on price throughout the study. Professor Hausman employed two tests to verify these assumptions--the Hausman specification test and the Chow test. Based upon these tests Professor Hausman rejected the assumption, and therefore, concluded that the entire regression analysis was invalid. (RX 46 at 11-20, Tr. 3969-70, 3979).

Complainant failed to introduce any evidence to show that its model does pass the Hausman or Chow tests. Instead it disputed the applicability of the Hausman test, and challenged Professor Hausman's method of performing the Chow test, as well as his interpretation of the results. The arguments made by Complainant are unpersuasive. Professor Hausman is a noted econometrician with considerable expertise in conducting these tests, particularly the Hausman test which he developed. I found him to be a most credible witness, and have consequently afforded great weight to his analysis of the econometric study.

Complainant further criticizes Professor Hausman for not creating his own multiple regression model to show a lack of a price difference, and for not proving that the IAS model had an upward bias. Complainant, however, has the burden of proof in this case; and it was, therefore, unnecessary for Respondent to develop a competing model. With respect to the direction of the bias, Professor Hausman testified that any bias in the model would render the results unreliable, and Complainant's arguments to the contrary are not convincing.

Professor Hausman also pointed out that the model is not reliable in that it failed to account for non-price conditions of sale. Variables were not included for the right of first refusal given to IBP, or for BMG's commitment to allow bidding on a pen-by-pen basis. The model did include a variable to account for extended delivery when it was taken; however, no variable was included to test the value of the option of extended delivery. Failure to include important variables which are related to the variable of interest can create bias in the results. (Tr. 3958). In fact, the government admits that any price difference resulting from these factors would appear in the \$0.43 per cwt. price difference. (Complainant's Reply Brief at 16). Omission of these terms, therefore, calls into question the accuracy of the results, since it cannot be determined from the regression whether or not it was these factors that actually caused the price difference.

Furthermore, the inaccuracy of the IAS model is corroborated by testimony of industry witnesses contradicting certain test results. The regression results suggest that whether a pen is predominantly heifer or steer has a greater effect on the price of cattle than does the percent of the pen that grades prime or choice. (Tr. 2406-11, CX 10 at 3, CX 25 at 72-73). Industry witnesses testified that the percent of a lot grading prime or choice is an important factor in determining price and stated that there is currently no real price distinction between steers and heifers. (Tr. 668-70, 737, 942, 1011-12, 1102, 1162, 1222-23, 1287-88, 1556-57, 1727-28).

Finally, even if the regression results were accepted as accurate for the period studied, that period cannot be found to be representative of the period covered by the Complaint. The IAS model only observed the effects of the agreement for the first ten weeks that it was in effect. Several industry witness testified that the market was volatile during this time period. (Tr. 772, 975, 1339). Complainant introduced evidence that, the market fluctuated in 10 out of the 12 weeks between February 14, 1994, and May 7, 1994. (Tr. 654-55). Since any price advantage would increase during periods of volatility, the regression results would have been exaggerated during the period studied.

Complainant admits that the market was volatile in 1994 (Complainant's Proposed Finding of Fact No. 13), but claims that such volatility was not unusual. There was no evidence introduced, however, suggesting that 1995 or 1996 were volatile. To the contrary, the government never looked at market changes during any other time period or made any attempt to discover whether the period selected for the study would provide an accurate representation of the effects of the agreement.

Complainant asserts that the study does not need to be representative of the entire time period at issue, but fails to explain this proposition. In fact, a study which uses an unrepresentative sampling cannot provide an accurate representation of the agreement; and accordingly cannot be used as the basis for proving an unreasonable preference. *See Capital Packing v. United States*, 350 F.2d 67, 76 (10th Cir. 1965).

The evidence does indicate that IBP must have on average paid a higher price for cattle purchased under the terms of the agreement than it did on regular transactions. Under the terms of the agreement BMG members were able to receive the benefit of any increase in the market value of their cattle, but were not subject to any downward fluctuation of the market. It is likely, therefore, that BMG members on average received a higher price than other yards.[5] The amount, however, is uncertain and unproven; and in any case, a price difference does not necessarily constitute a preference.

C. Complainant failed to prove that the price difference constituted a *preference.*

Although Respondent may have paid higher prices on sales transacted under the terms of the agreement, it was not only paying for cattle; it was also paying for a number of bargained for non-price conditions of sale. Respondent obtained valuable benefits under the agreement including a right of first refusal and an option for extended delivery. Assuming, for the sake of argument, that Respondent did pay $0.43 per cwt. more for cattle from BMG yards, these added benefits appear to be worth at least that much. Respondent, therefore, cannot be said to have given the BMG yards a preference.

1. Right of First Refusal

Under the agreement, Respondent initially had a right of first refusal on all cattle for which it bid even or better. Subsequently, the right was expanded to include cattle on which IBP bid "minus 50."

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[5]The conclusion that Respondent must have paid somewhat more for cattle under the agreement is also consistent with the fact that Respondent received superior non-price terms of sale under the agreement which would not likely have been offered for free. *See infra* Discussion at Part C.

Complainant asserts that Respondent did not have a right of first refusal under the agreement, citing testimony from cattle producers who fed cattle at Great Bend Feeders and Pratt Feeders, who did not know about that term. It is true that several producers were unaware that the right existed; however, most of them were also unaware of the extended delivery term, the existence of which Complainant does not dispute. (Tr. 1764-65, 1789-90, 1824, 1874, 1944-45). The former assistant feedyard manager at Great Bend explained that he did not provide producers with all of the details of the agreement because he did not want them to be unnecessarily confused. (Tr. 3913). Pratt sold under the terms of the agreement for only one year, so it is unlikely that all of its customers would be aware of every term.

Complainant also maintains that the right of first refusal did not exist because it was not enumerated in a one page summary of terms signed by Lee Borck and Bruce Bass. (CX 2 at 2). Complainant refers to the memorandum as the "Beef Marketing Agreement," and insists that it represents the agreement in its entirety.[6] Complainant, however, cannot bypass the intent of the parties, and unilaterally decide that the memorandum was a complete integration of the terms of the agreement.[7] Complainant did not offer any evidence to show that terms are limited to those

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[6]Complainant's attempts to limit the terms of the agreement to those memorialized in the one page summary appear to be disingenuous. The memorandum was not presented to Complainant as anything more than a summary of terms. When Respondent faxed a copy of the memorandum to Complainant, it bore the notation: "Keith, This would be the *general guidelines* on how the purchases are occurring." (CX 2 at 1) (emphasis added). In addition, Complainant recognizes additional terms in other contexts. The Complaint itself refers to the adjustment of price for cattle quality, as well as the change in method of calculating price, which occurred in September 1994 (Complaint para. II(a)), neither of which are included in the summary, thereby acknowledging that the document contained in CX 2 is not representative of the agreement in its entirety.

[7]*Cf. Battery Steamship Corp. v. Refineria Panama, S.A.*, 13 F.2d 735, 739 (2d Cir. 1975); *United States v. Clementon Sewerage Authority*, 365 F.2d 609, 613 (3d Cir. 1966); *Greenberg v. Tomlin*, 816 F. Supp. 1039, 1052 (E.D. Pa. 1993); *Monon Corp. v. Wabash Nat. Corp.*, 780 F. Supp. 577 (N.D. Ind. 1991).

contained in the memorandum; and, in fact, the evidence establishes that the agreement between BMG and Respondent was intended to, and did, contain additional terms including a right of first refusal.

Several witnesses, including those testifying for the government, stated that the right of first refusal existed. Bruce Bass and Lee Borck, who negotiated the agreement both testified that there was a right of first refusal. (Tr. 3512-13, 3734). Jerry Bohn, the general manager of Pratt feedyards testified for the government that the right of first refusal was part of the agreement; and explained that a disagreement over that term caused Pratt to stop selling under the agreement. (Tr. 462). Ray Palenske, an IBP buyer, and Marvin Stilgenbauer an Excel buyer, also testified for the government that there was a right of first refusal. (Tr. 830, 1595). Finally, Jay Johnson, Chief of the Packer Branch of P&S, testified as a representative of the agency that IBP had a right of first refusal, and that the right had a value. He further stated that he knew the right existed at least as early as January 1995. (Tr. 3231-32). Assertions that the right did not exist are, therefore, inconsistent with the evidence of record.

Complainant further argues that even if the right of first refusal did exist, it was not worth any extra payment. On the contrary, the right of first refusal is quite valuable. Along with IBP's commitment to make a good faith bid on every pen, it helped Respondent maintain a steady supply of high quality cattle, close to the Emporia plant. After the agreement went into effect, IBP's purchases from BMG yards nearly doubled; and capacity utilization at Emporia increased by 66 head per week. Increased capacity utilization translated into increased profits since labor and other fixed costs remained constant with the increase. In the first ten weeks of the agreement, the added cattle accounted for an additional contribution of $17,609 from the slaughter division and an additional

$23,765 from the processing division, for a total increase in profits of $41,374. (Tr. 3825-32, RX 8).

The right of first refusal also allows Respondent's buyers to be the first bidder at BMG yards without having to arrive at dawn, or sooner; and it eliminates repeated telephone calls and trips to the feedyards during the negotiating process. (Tr. 881-82, 3467-68). Increased efficiency certainly has value, even if it was not quantified. Complainant recognized this value in its econometric study, which hypothesized that price would increase with the number of head in each lot due to increased efficiency related to purchasing larger lots. (CX 25 at 54).

In the alternative, Complainant asserts that even if the right of first refusal was a valuable benefit that Respondent received from the agreement, it is anti-competitive and unlawful under the Act, and, therefore, should not be considered. Complainant, however, failed to introduce any evidence that the right of first refusal as exercised by Respondent caused any harm to competition; and failed to cite any precedent indicating that rights of first refusal are considered to be anti-competitive. Jay Johnson merely stated it is the agency's position that the right of first refusal violates the Act because it will suppress the bidding process. (Tr. 4414, 4439-40). Such generalized statements of potential harm are insufficient to show that a practice violates the Act. *See Central Coast Meats, Inc. v. USDA*, 541 F.2d 1325 (9th Cir. 1976); *Corona Livestock Comm'n v. USDA*, 607 F.2d 811 (9th Cir. 1979).

2. Extended Delivery

Under the agreement, Respondent is able to delay its pick up of cattle as many as three extra days. Delivery can be scheduled as many as ten days following the sale, instead of the customary seven days. Complainant argues that this term does not have value because packers could sometimes get extended delivery without the agreement.

The record evidence shows that even though feedyards do at times give extended delivery, such extensions are not normal practice. (Tr. 447, 918, 944-47, 1132-33, 1226-27, 1733-36). IBP buyer Ray Palenske testified that he could normally get one extra day from a feedyard if he begged. He also testified, however, that it is "very, very, very, difficult" to get more than one extra day for free. (Tr. 837). Excel buyer, Robert Albrecht, testified that feedyards would give him an extra day approximately fifty percent of the time that he asked for one. (Tr. 1633). The record further shows that some feedyards are particularly resistant to the practice of extending delivery. Kenneth Wiens, of Central Feeders, for example, testified that although he sometimes gives extra days he "frowns on" the practice; and he has some customers who never allow extra time. (Tr. 739-40). Allen Sents, of McPherson County Feeders, testified that he tries to avoid giving extended delivery. (Tr. 970). Wendall Zimmerman, of Zimm's Feedlot, testified that he "very seldom" allows delivery beyond seven days. (Tr. 1077-78). Lowell Sawyer, of O.K. Corral, testified that he is opposed to giving extended delivery terms, and will only allow it "very occasionally." (Tr. 1289-90). None of the feedyard operators testified that they would guarantee ten day delivery on all sales, for free.

There is a difference between being able to obtain extended delivery sometimes, and having the right to take extra days on any transaction, for any reason. This difference was of economic value to IBP.

The availability of extra days benefited Respondent by allowing greater flexibility in scheduling delivery of cattle for slaughter. The Emporia plant kills approximately 4,000 head each day; and cattle are generally slaughtered on the same day they arrive at the plant. (Tr. 3474). The scale house coordinator must schedule daily shipments in a way which accommodates IBP's inventory without overburdening the plant. Having three extra days to work with helps to ease scheduling pressures, while enabling IBP to maximize its inventory.

Also, it is unlikely that feedyards would grant three extra days as a matter of right without some compensation for the cost of feeding the animals those additional days. Steve Sellers, of Sellers Feedlot, testified that after seven days it can cost $0.50 per cwt. or more to feed an animal for a single day. (Tr. 1308-09). Jerry Anderson, of Mid-America Feedyards, testified that a ten day delivery period could cost as much as $5.00 per cwt. more than a seven day delivery period. (Tr. 1736). Furthermore, the cattle owner bears the risk of any type loss, which would include death, injury, or weight loss, during the extra days. In high risk situations--such as when a storm is forecast--an owner would likely deny extended delivery terms under a regular sale, but would be unable to refuse the days to IBP. (Tr. 1013-14). Due to the extra risk and cost to the feedyards, it is to be expected that they would impose a compensatory charge. Complainant's econometric study recognized this fact: "Feedlot managers are reluctant to hold cattle beyond the standard delivery period since delayed delivery increases costs to the feedlot. Thus, we expected that feedlots would demand additional compensation to hold cattle for extended delivery and IBP, inc. would incur higher costs of cattle." (CX 25 at 58).

Complainant also argues that extended delivery is not worth $0.43, because it is rarely used. This argument fails for two reasons. First, an option has value whether exercised or not. Second, the option was exercised. The agency's expert witness, Dr. Gerald Grinnell, testified that IBP took delivery from BMG members after seven days more than fifty percent of the time. (Tr. 2077-78). Complainant's statistical analysis further shows that the average number of days between the sale and delivery of cattle from BMG yards increased by almost two days after initiation of the agreement. (CX 9 at 131).

3. <u>Pen-by-pen Bidding</u>

Respondent also advances the agreement's provision for pen-by-pen bidding as a valuable right. Although it is possible that this term may have had some value to Respondent, such value is not unequivocally established by the record. Although feedyards may have traditionally tied lesser quality pens of cattle to higher quality pens, it appears that currently in Kansas, pen-by-pen bidding is consistently available without the agreement. In any case, it is not necessary for the potential value of the pen-by-pen bidding term to be established, since the right of first refusal and extended delivery terms are sufficient to account for a $0.43 per cwt. price difference.

D. Complainant failed to prove that Respondent provided a preference which was *undue* or *unreasonable.*

Even if Complainant had proven that Respondent afforded the BMG yards a preference in the form of a $0.43 per cwt. price advantage, it failed to prove that such a preference would be "undue" or "unreasonable."

The Act does not specify what constitutes "undue" or "unreasonable," instead those terms must be defined according to the facts of each case. *See Capital Packing Co. v. United States*, 350 F.2d 67, 76 (10th Cir. 1965). The facts of this case do not conclusively establish that a $0.43 per cwt. price difference would be sufficient in amount to be "undue" or "unreasonable."

A $0.43 per cwt. price advantage on a typical 1200 pound animal would amount to approximately $5 per head. At the time of the study, IBP's average live cost for cattle was approximately $75 per cwt. (CX 12 at 158), or $900 for a typical 1200 pound animal. Consequently, a $0.43 per cwt. difference represented only about one half of one percent of the purchase price of a typical animal.

Complainant asserts that \$0.43 per cwt. is undue or unreasonable because it is significant in comparison to producer profits and bidding increments. Some witnesses testified that on average, in 1994, they suffered losses on their cattle ranging from \$1.50 to \$8.00 per cwt. (Tr. 556-57, 1000, 1085, 1194). There was also testimony that although bids in Kansas are currently made in increments of \$1.00 per cwt., in 1994, increments of \$0.50 per cwt. were more common, and sometimes bids differed as little as \$0.10 per cwt. (Tr. 697, 916-17, 968-69, 1083, 1260).

On the other hand, the cost of gain at feedyards can vary as much as \$15 to \$30 per cwt. (Tr. 3709-11). In comparison, it is questionable whether a difference of \$0.43 per cwt. would significantly affect either profit or placement of cattle by producers. This conclusion is supported by testimony from producers which indicates that the agreement had little if any effect on any of their decisions on where to place cattle, as well as by the fact that Pratt Feedyards and Pawnee Valley Feeders withdrew from the agreement, while remaining members of the Beef Marketing Group. Whatever price advantage the agreement afforded, it was not sufficient to induce them to continue under its terms.

Furthermore, the size of a price difference is not the only consideration in determining whether a preference is undue or unreasonable. In *Jackson v. Swift Eckrich*, the district court held that a practice which is supported by a valid business purpose is not unreasonable. 836 F. Supp. 1447, 1456 (W.D. Ark. 1993), *aff'd*, 53 F.3d 1452 (8th Cir. 1995); *see also Capital Packing Co. v. United States*, 350 F.2d 67, 80 (10th Cir. 1965); *Armour & Co.*, 402 F.2d at 725. Respondent had valid business purposes for entering into the agreement with BMG. BMG's previous arrangement with Excel had impaired Respondent's ability to obtain cattle in central Kansas. By entering into the agreement with BMG, Respondent was able to secure a steady supply of high quality cattle close to the Emporia plant. The agreement was beneficial to Respondent in that it resulted in reduced shipping distances, and increased efficiency and plant utilization. (Tr. 3522, 3528-30). In addition, because Respondent has purchased a substantial amount of cattle from the BMG yards since the initiation of the agreement, and has provided the yards with carcass performance information, the feedyards have been able to tailor cattle production to best meet Respondents needs, and improve cattle quality. (Tr. 3755).

Respondent also had valid business reasons for not extending the terms of agreement to all feedyards in Kansas. For one, Respondent utilizes different purchasing methods in order to diversify risk. Selling under the same terms to all feedyards would defeat that purpose. Also, the agreement required Respondent to make a good faith bid on all pens of cattle at the BMG yards. If the agreement were extended to all of the feedyards in Kansas, Respondent could be forced to bid on substantially more cattle than it has the capacity to slaughter.

Finally, in *Armour and Company*, the court found that the words undue, unreasonable, unjust and unfair required some examination of intent and the likely effect of the practices; and held that there could not be a violation of section 202(a) in the absence of anti-competitive intent or effect. *Armour & Co.*, 402 F.2d at 717-18. The agency failed to assert that there was any predatory intent on the part of IBP, or any disruption to competition resulting from the agreement. In fact, the agreement has not caused any harm as anticipated by the Act, and, therefore, cannot be said to be undue or unreasonable. *See infra* Discussion at Part F.

E. Respondent did not use an unfair, unjustly discriminatory, or deceptive practice or device.

Complainant alleges that Respondent used discriminatory practices in violation of section 202(a), by failing to offer the terms of the agreement to all feedyards in Kansas. The agency, however, cannot compel Respondent to enter into the same contract, or any contract, with every feedyard in the state.

In *Jackson v. Swift Eckrich, Inc.*, 53 F.3d 1452 (8th Cir. 1995), the Court of Appeals for the Eighth Circuit held:

> [The agency's] claim in essence, is that § 202 of the PSA . . . statutorily creates an entitlement to obtain the same type of contract that Swift Eckrich may have offered to other independent growers. We are convinced that the purpose behind § 202 of the PSA . . . was not to so upset the traditional principles of freedom of contract. The PSA was designed to promote efficiency, not frustrate it.

Id. at 1458. *See also Philson v. Cold Creek Farms, Inc.*, 947 F. Supp. 197, 202 (E.D.N.C. 1996).

Consequently, it is not enough for the government to show that Respondent bought cattle using different methods and different terms of sale. In order to show a violation of the Act, Complainant was required to prove that the agreement caused the kind of harm that the Act is designed to prevent. This distinction was explained nearly sixty years ago:

> Differences or variations in prices, or in the terms of credit, or amounts of discount, or in practices do not come within the ban of the act unless they in fact constitute engaging in or using an unfair or unjustly discriminatory or deceptive practice or device in commerce or unless they constitute a making or giving, in commerce of an undue or unreasonable preference or advantage, or result in undue or unreasonable prejudice or disadvantage as between persons or localities.

Swift & Co. Wallace., 105 F.2d 848, 853 (7th Cir. 1939). In *Armour & Co.*, the court stated again that price differences are not illegal absent anti-competitive intent, quoting the following passage from a Ninth Circuit anti-trust decision:

> [T]he object of the anti-trust law is to encourage competition. Lawful price differentiation is a legitimate means for achieving the result. It becomes illegal only when its is tainted by the purpose of unreasonably restraining trade or commerce or attempting to destroy competition or a competitor, thus substantially lessening competition, or when it is so unreasonable as to be condemned as a means of competition. The price reduction here has none of these stigmata.

Armour & Co., 402 F.2d 712, 720 (7th Cir. 1968) (citing *Balian Ice Cream Co. v. Arden Farms Co.*, 104 F. Supp. 796, 807 (S.D. Cal. 1952)), *aff'd* 231 F.2d 356 (9th Cir.), *cert. denied* 350 U.S. 991 (1955). *See also Central Coast Meats v. USDA*, 541 F.2d 1325, 1327 (9th Cir. 1976).

F. The agency failed to prove that the agreement caused the type of harm the Act is designed to prevent.

In addressing the type of harm which must be shown under section 202, courts have disagreed on whether there is a requirement that there be an injury to competition, or whether injury to competitors is enough. Some cases have held that because the PSA is broader than general antitrust law, that injury to competitors is sufficient. *See Wilson and Co. v. Benson*, 286 F.2d 891 (7th Cir. 1961), *Swift & Co. v. United States*, 393 F.2d 247 (7th Cir. 1968). Generally, however, courts have focused on whether there was actual or likely injury to competition. *See, e.g., Swift & Co. v. Wallace*, 105 F.2d 848 (7th Cir. 1939); *Berrigan v. United States,* 257 F.2d 852 (8th Cir. 1958), *Aikens v. United States*, (10th Cir. 1960), *Armour Co. v. United States*, 402 F.2d 712 (7th Cir. 1968), *Farrow v. USDA,* 760 F.2d 211 (8th Cir. 1985). It is not necessary, however, to determine which standard should be applied, as Complainant failed to show requisite injury under either standard.

Complainant did not attempt to show injury to competition, opting instead for the lower standard of injury to competitors. Complainant, however, failed to prove that any competitors, be they packers, producers, or feedyards, were injured as a result of the agreement.

Central Feeders, Ottawa County Cattle Association, Mann's ATP, and Mid-America Feedyards all expanded after the agreement between BMG and IBP went into effect. Although some feedyard operators suspected that they lost some business as a result of the agreement, there was no evidence to substantiate these suspicions. (Tr. 987, 1197-98, 1266-67, 1348). To the contrary, the testimony from producers indicated that membership in the Beef Marketing Group was not of particular concern to them in making cattle placement decisions.

Kim Goracke testified that when selecting a feedyard he relies primarily on the recommendations of his nutritionist; and that he feeds at Pratt even though the terms of the agreement are no longer available there. (Tr. 1750, 1763). Lynn Rock testified that he was not concerned enough about the agreement to ask a feedyard whether it was a BMG member before placing cattle there. He further testified that although he would rather sell to a BMG yard than a non-BMG yard if all else were equal, all else is not equal among feedyards. (Tr. 1803). Lynn Kauffman testified that the agreement has not affected his placement decisions in the last several years; and that although he sold to Pratt under the terms of the agreement in 1994, he continued to sell at Pratt after the agreement was no longer available. (Tr. 1814). When deciding where to place cattle, Mr. Kauffman testified that he considers pen availability, cost of gain, feed supply, general appearance of the yard, and trust and friendship with the yard operators. (Tr. 1817-1822). Walter Krier testified that he places his cattle based on friendship and loyalty, and who does the best job with feeding and marketing. (Tr. 1860-61). Ralph Hembree testified that he decides where to place cattle based on recommendations from other people in the cattle business, such as feed salesmen. Mr. Hembree was not sure whether or not all of the yards where he fed his cattle were BMG members. (Tr. 1921, 1938-38).

Furthermore, Complainant admits that non-BMG yards continued to receive competitive prices despite the agreement. (Complainant's Reply Brief at 68). Jerry Bohn, the general manager of Pratt Feeders, testified that he continued to receive the best price available each week after withdrawing from the agreement. (Tr. 540). In fact, he stated that Pratt benefited from the existence of the agreement after it withdrew, because there was greater interest from Respondent's competitors. (Tr. 539).

Finally, the agreement was entered into in an attempt to meet competition. Had Respondent refused BMG's offer to enter into the agreement, BMG would have offered it to another packer. The prior agreement between BMG and Excel, which the IBP-BMG arrangement replaced, had been an impediment to Respondent's acquisition of cattle in central Kansas. Any agreement between BMG and another packer could have created similar difficulties. By accepting the agreement offered by BMG, Respondent was able to ensure this would not occur. The Act was intended to prevent anti-competitive activities, not to prevent competition. To the extent that Respondent's participation in the agreement with BMG was an attempt to successfully compete with other packers in Kansas, it cannot be considered violative of the Act.

In the absence of any intended, actual, or likely injury to competition or to competitors, it cannot be found that the agreement causes any of the harms sought to be prevented by the Act. As such, it cannot be found that the agreement violates the Act. Although the terms of the agreement provide for a method of sale which is different from methods traditionally used in Kansas, Respondent has always been an innovator in the industry. So long as the methods of transaction used are not anti-competitive in nature, there is no reason for the government to stifle such innovation by interfering with Respondent's business judgment and freedom to contract.

For the foregoing reasons the following Order is issued.

Order

The Complaint is hereby dismissed.

This Decision and Order shall become final and effective without further proceedings 35 days after the date of service upon the respondent, unless it is appealed to the Judicial Officer by a party to the Proceeding within 30 days of service pursuant to section 1.145 of the Rules of Practice (7 C.F.R. § 1.145).

Copies hereof shall be served on the parties.

VICTOR W. PALMER
Chief Administrative Law Judge

September 25, 1997